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SUBJECT: GHANA'S ENERGY CRISIS: RESTRUCTURING TOWARD FULL COST-RECOVERY

Ref: A) Accra 847; B) Accra 1012; C) Accra 1791; D) Accra 282

¶11. (U) SUMMARY: This is the fourth in a series of cables on Ghana's energy sector. The first, ref A, provided background on the crisis and near-term remedial measures. The second, ref B, focused primarily on the impact of the crisis on the mining sector. The third, ref C, provided an update on the crisis and progress in putting in place new generation capacity. This cable addresses distribution, transmission and regulatory issues. The GoG reform efforts are being anchored by a recently approved \$95 million World Bank/Global Environment Facility (GEF) Ghana Energy Development and Access Project (GEDAP). Tariff reform, utility company restructuring, enhanced regional cooperation and expanded access to power are among the critical elements Ghana needs to implement in the near term if it wishes to attract investment and spur private sector development to meet its growth and poverty reduction goals.
End Summary.

WORLD BANK ASSISTANCE

¶12. (U) In July, the World Bank approved a \$95.5 million Ghana Energy Development and Access Project (GEDAP) comprised of a \$90 million concessional loan from its International Development Association and a \$5.5 million grant from the GEF. The aim of GEDAP is to improve institutional capacity of the regulator and utility companies, improve distribution and increase energy efficiency (Ghana loses an estimated 25% of what is generated in distribution), scale-up energy access to reduce urban-rural imbalances, and encourage the development of renewable energy.

¶13. (U) Among the initiatives to be carried out under GEDAP is the creation of a Rural Electrification Agency that will coordinate the connection of 134,000 new customers in rural villages to the national grid and accelerate achievement of full rural electrification from 2020 to 2015. Loan disbursement will depend on making progress in key areas such as tariff adjustment, improving performance of the Volta River Authority (VRA - responsible for most generation) and the Electricity Company of Ghana (ECG - responsible for distribution), obtaining management support services for ECG, and submitting a renewable energy law to parliament.

TOWARD FULL COST-RECOVERY

¶14. (U) The GoG has been absorbing proposed end-user tariff increases for more than a year, at a high financial cost. The direct operating and maintenance cost of thermal energy in 2006 was 3.8 trillion cedis, or approximately \$408 million. That amount was above the total revenue of VRA in 2006. In 2007, the thermal/hydro mix tilted even more toward thermal (and higher costs) with more than half of the electricity generated by VRA now coming from thermal sources. Currently, the GoG provides subsidies worth about \$30 million monthly - largely from tariff absorption. VRA is

currently discussing with the World Bank the option of separating the financial and managerial aspects of hydroelectric and thermal power to prevent hidden cross-subsidization of less efficiently-run thermal plants (VRA has more expertise in hydro) and make revenue streams more transparent.

¶ 15. (SBU) [COMMENT: VRA's poor financial health nearly led to the shut down of Ghana's joint-venture thermal plant at Takoradi. VRA was 12 months in arrears in payment to the private partner, TAQA (formerly CMS Energy). TAQA forced the issue by scheduling a press conference announcing a shut down of the plant, and the GoG paid more than \$30 million in the nick of time. Although the GoG found the money to clear the arrears, it placed additional pressure on the budget. Ghana has rescheduled some promissory notes and are eagerly awaiting the proceeds from the planned sovereign bond issue (ref C) to relieve the budget pressure. END COMMENT.]

¶ 16. (U) As part of ongoing reform efforts, the Public Utilities Regulatory Commission (PURC) determined average cost-recovery tariffs in May 2006. The proposed increases were not immediately passed to consumers because the government felt there needed to be improvements in service before consumers could be expected to pay more. The increase was slated to take effect in November 2006 but the government again decided to absorb the costs. In April, 2007, the GoG committed to achieving full cost-recovery tariffs by the end of 2007; it is one of the critical measures Ghana said it would take to address its fiscal deficit. GoG acceptance of the need to move to cost recovery is not a new development but the energy crisis has added urgency to the reform.

¶ 17. (U) Cost-recovery tariffs at the May 2006 level (944 cents per kilowatt hour) were finally implemented in May 2007 for commercial users. The tariffs are still below true cost-recovery since costs

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have risen over the last year. Residential users were supposed to begin paying increased tariffs August 1 but rates have not changed. The Public Utility Regulatory Commission (PURC), whose mandate is to set tariff levels, will conduct an operational and technical audit of utilities and a tariff study by the end of March 2008 as part of GEDAP.

¶ 18. (U) PURC's forthcoming multi-year tariff regime framework will provide the basis for passing full costs to end-users. However, considerable debate can be expected regarding tariff dispersal, e.g., should industry pay higher rates than the poor. The GoG is faced with balancing priorities such as providing affordable power to the underserved and attracting new industrial investment in the face of stiff regional and global competition. In a recent radio interview PURC's Chairman estimated that a 20 percent tariff increase could bring VRA and ECG to cost recovery not including the high generating cost of the diesel-fueled emergency power plants.

UTILITY SECTOR REFORM

Transmission

¶ 19. (SBU) The Ministry of Energy recently created an Electricity Transmission Utility, the Ghana Grid Company (GridCo), to take over the transmission activities of VRA and help create a level playing field for IPPs. GridCo is state-owned but autonomous and will manage operations and maintenance, as well as the import and export of West Africa Power Pool (WAPP)-produced electricity. PURC's Technical Manager for Energy indicated that the separation is sorely needed but will be difficult to implement. He said account separation is not a problem but sorting out shared facilities and ongoing lending programs will be a challenge, as will the fact that Gridco, as a new company, has no track record that would enable them to easily access financial resources.

Distribution

110. (SBU) The Electricity Company of Ghana (ECG) is responsible for distribution. Under a plan agreed between the GoG and donor partners, ECG was to be put under a management contract supported by the Swiss. However, because of negative experiences with management contracts in the telecom and water sectors, the GoG decided not to move forward. Instead, the Ministry of Energy said it wishes to move forward with a plan to restructure ECG into a holding group with five subsidiary companies. The holding group would provide broad policy direction while subsidiaries would be responsible for service delivery and maintenance and held accountable for agreed performance standards and incentives. According to an Economic Advisor at the Swiss Embassy, the Swiss are now considering whether to provide support to ECG through a consultancy and hopes to have a program in place by early 2008. The ECG and the Ministries of Energy and Finance concluded a Performance Contract in January 2007 that sets out service and revenue standards for ECG and may be a basis for performance benchmarks for the potential consultancy.

111. (SBU) [COMMENT: The existence of the performance contract was news to donor partners, even those most closely engaged in the energy sector. It has not been publicized at all and was brought to the attention of the Swiss only in August, even though donors had held intensive discussions with the GoG about performance indicators related to ECG. The value of restructuring ECG as outlined by the Minister is not entirely clear. The Minister touted it as part of the decentralization process but it could also simply further weaken an already weak structure. END COMMENT.]

REGIONAL INITIATIVES TOWARD EFFICIENCY

WEST AFRICA POWER POOL (WAPP)

112. (U) WAPP's goal is to integrate the regional power grid to create a regional energy reservoir from which West African countries can draw back-up power to reduce vulnerability to local disruptions. WAPP's implementation is guided by a "master plan" of capital investments required by each country in the region to meet its energy needs.

113. (U) A key piece of the WAPP is a 330 kilo-volt coastal transmission backbone that will interconnect power lines across borders and establish new lines within Ghana to transfer power to other countries. The Lagos (Nigeria) - Sakete (Benin) portion of this line was commissioned February 13, 2007, thereby enabling Benin and Togo to be supplied with Nigerian power, in addition to Ghanaian

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power, which they already can receive. In the face of domestic shortages, VRA reduced power supply to Togo and Benin from 100MW to 25MW earlier this year.

114. (U) To maximize benefit from the WAPP, which attracts and facilitates investment in power assets, the GoG needs to invest about \$8 million in new transmission lines. VRA's financial woes have slowed the pace of investment which, in turn, slows WAPP progress. The next priorities are to complete the Aboadze (Takoradi) - Volta (Tema) line and then the Volta - Sakete portion. The WAPP Secretariat has urged GoG to prioritize the financing of the Obuasi - Kumasi line, which will eventually connect with the Takoradi thermal plant (T2), which has long been slated for expansion from 220MW to 330MW. The GoG insists that even though T2 expansion has been pending for years, it will be completed. If so, it would help to relieve the western bottleneck which has exacerbated transmission losses.

WEST AFRICA GAS PIPELINE (WAGP)

115. (U) The West Africa Gas Pipeline (WAGP) which will channel Nigerian gas to Benin and Togo, and Tema and Takoradi in Ghana, has faced numerous hurdles that have delayed completion such as

political instability in gas producing areas, sale of a subcontractor to another company, challenging shore crossings, and pipe rupture.

¶16. (U) The WAGP, in which Chevron has the highest percentage of ownership in the West Africa Pipeline Company consortium, is now scheduled to come online during the second quarter of calendar year 2008, though targets for completion have repeatedly slipped. Though the WAGP will not provide additional generating capacity, gas will significantly reduce the cost of energy (operating costs will decrease by 30-40 percent by switching from fuel oil) and could induce additional private investment.

¶17. (SBU) The Gas Purchase Agreement among the WAGP countries calls for 20 years of gas flow from Nigeria (about 135 cubic feet of gas per day - 124 for VRA and 11 split between Togo and Benin). Gas will be supplied by Shell, Chevron, and the Nigerian National Petroleum Corporation. Nigeria initially agreed to supply Ghana with enough gas to run approximately 660MW of thermal generation, but most experts project that gas demand will exceed supply and, as early as 2010, demand will be twice the supply. Nigeria claims supply constraints are temporary but the uncertainty adds an additional risk for prospective independent power producers.

¶18. (U) To maximize the benefit from the WAGP, Ghana should develop a secondary gas market, which would provide a source of fuel for industry and an incentive for additional investment in power generation. Regarding this secondary gas market, more than two years ago USAID contractors provided advice to the GoG on developing a regulatory framework. GOG has yet to adopt the regulations and necessary policy elements for the market to exist.

COMMENT

¶19. (SBU) COMMENT: Avoiding future energy crises in Ghana will depend largely on Ghana's ability to get its utilities on solid financial footing and the regulatory environment right for sustainable private investment in the energy sector. Per reftels, the GoG is addressing the energy crisis but, for the moment, it is doing so primarily through expensive emergency generation investment. Over the medium to long-term, it needs to make significant progress in providing broader access to power for all Ghanaians and to stem the financial and technical losses that currently characterize the sector. END COMMENT.

BRIDGEWATER